United States Department of Agriculture

Farmers Home Administration

Washington D.C. 20250

FmHA AN 1561 (422)

March 13, 1987

SUBJECT: Appraising Farm Real Estate Prices and Expenses

TO: All State Directors, State Directors-at-Large, Chiefs of Farmer Programs, District Directors and County Supervisors, FmHA

Purpose/Intended Outcome:

This AN is to clarify what prices and expense to use in completing the capitalization approach and provide consistency in appraising agricultural property.

Comparison with Previous AN:

No previous AN exists on this subject.

Implementation Responsibilities:

In accordance with FmHA Instruction 422.1, prices and costs of producing farm products for use in making FmHA appraisals must reflect a level representative of the agricultural value of farm property in the forseeable future. Average prices and current expenses will not always provide an accurate reading of current and future trends. We find long-term averages (more than five years) place too much importance on the distant past and ages (less than five years) may be distorted by unusual circumstances that may not recur.

A moving weighted average for a five year time period most closely reflects market anticipation. We suggest using a five year moving average to develop the State schedule required by FmHA Instruction 422.1 V B. As data becomes available for the current year, the most remote year in the series is dropped. Furthermore, the most recent year is weighted more heavily than the most remote year. The appraiser will need to weigh the most recent year in the series five times as much as the remote year. (See Attachment A).

EXPIRATION DATE: September 30, 1987

FILING INSTRUCTION: Preceding FmHA Instruction 422.1

When estimating commodity prices, the appraiser must not overlook geographical and seasonal price variations and their influence on the subject property. In addition, transportation costs to markets influence prices a farmer or rancher can anticipate.

FmHA Instruction 422.1, Paragraph IV B 2 states that an appraiser should look at the rental income which could be expected from a farm when the capitalization approach is used to determine market value. Paragraph I E 7 of Exhibit A of the Instruction explains that rental terms used by an appraiser should be those which are customary in the area and should take into account the expenses normally paid by the landlord. Under a variety of rental agreements, both cash and crop share, the expenses may change from crop to crop, area to area, or year to year. Therefore, the expenses deducted should be consistent with the typical expenses for the area at the time of the appraisal. The expenses used in the analysis of the data must be consistent between the subject and comparable properties. Some of the expenses that may be a part of an expense analysis are taxes, insurance, maintenance, management fees, irrigation charges and labor costs.

The source of expense data are varied, and the records from the subject property provide a good place to start. (If records on the subject property are not available, the Agricultural Extention Sevice and University cost summaries are sources that should be used). In the analysis of a landlord's expense statement, the appraiser must make sure charges included by the landlord are related directly to the management and operation of the farm and do not include irrevelant expenses, even though such expenses may be legitimate expenses or deductions on the owner's income tax statement. A list of expense items encounted in an owner's expense statement, which should not be included in the estimate of expenses related to the income producing capability of the property are depreciation, mortgage interest, income tax, additions to capital and unusual owner expenses not directly related to the income producing capability and operation of the farm. Depreciation or the recapture of capital improvements are not handled as a separate expense item on Form FmHA 422. The depreciation of real property is captured under maintenance and represents that expense directly related to the nature of the income.

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In those States where prices and expenses are calculated in a manner contrary to the guidance provided in the subject AN by State Instructions, State Supplement, State Bulletins or Administrative Notice, immediate steps should be taken to rescind such directives.

Vance L. Clark

VANCE L. CLARK
Administrator

Attachment

Attachment A
Example

Weighted Average

YEAR:	1982	1983	1984	1985	1986
PRICE:	2.60	2.40	2.10	2.00	1.90 x 5 = 9.50
TOTAL:	18.60				

Formula

$18.60 \div 9 = \$2.07$ (Weighted Average Price)